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Biden's Tax Plan and Real Estate

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I. Background

On Friday, May 28, 2021, the U.S. Treasury Department ("Treasury") issued the "Green Book" describing the Biden Administration's tax proposals in connection with its proposed budget. The Green Book has been much anticipated, since the brief discussion of tax provisions included in the Biden Administration's proposed American Jobs Plan and American Families Plan provided little in the way of details. The Green Book does provide additional details with respect to the proposed tax provisions, although the descriptions leave many important questions unanswered. But one thing is clear—if the tax provisions described in the Green Book are enacted into law, the real estate industry (*e.g.*, sponsors, developers, investors, and others) will have a lot to think about.

II. Increase in Tax Rates

A. Individuals

Consistent with the fact sheet describing the American Families Plan, the Green Book describes a proposal whereby the top tax rate for ordinary income earned by individuals would increase to 39.6 percent. In 2022, this top rate would apply to married individuals filing jointly who make more than $509,300 and unmarried individuals who make more than $452,700. Those thresholds would be

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adjusted for inflation in future years. The increased rate for individuals would be effective for taxable years beginning after December 31, 2021.

Of greater significance for most individuals who participate in the real estate industry, capital gain rates would increase so that, for married individuals making more than $1 million, the rate would be the same as applies to ordinary income. More specifically, the Green Book states that "[l]ong-term capital gains and qualified dividends of taxpayers with adjusted gross income of more than $1 million would be taxed at ordinary income rates, with 37 percent generally being the highest rate (40.8 percent including the net investment income tax), but only to the extent that the taxpayer's income exceeds $1 million ($500,000 for married filing separately), indexed for inflation after 2022." A footnote then states: "A separate proposal would first increase the top ordinary individual income tax rate to 39.6 percent (43.4 percent including the net investment income tax)." The effective date is stated to be "after the date of announcement." Although not entirely clear, the intention appears to be that capital gains would be taxed at the top ordinary income rate, which would be 37 percent from the date of announcement until December 31, 2021, and then 39.6 percent thereafter.

As described in the Green Book, the income thresholds do not appear to represent a cliff. Instead, the increased rate applies only on the portion of capital gain that is part of total taxable income in excess of $1 million (or $500,000 for married taxpayers filing separately). In other words, for a married couple filing jointly who has total taxable income of $1.2 million, $400,000 of which is capital gain, the 39.6 percent rate would apply to $200,000 of capital gain (*i.e.*, the portion in excess of $1 million).

As noted above, the Green Book states that the provision will be effective for gains recognized "after the date of announcement." The intention in using this phrase is not clear. The date of announcement may reference the date when the fact sheet for the American Families Act was released, which was April 28, 2021. Alternatively, it may reference the date that the Green Book was released—May 28, 2021. In any event, this immediate, or possibly retroactive, effective date may represent an effort on the part of the Biden Administration to prevent a race to sell assets in advance of an increase in rates.[1] It is important to recognize that the Biden Treasury cannot set the effective date for legislation—the ultimate effective date will be established by Congress and will be the product of negotiations among numerous stakeholders.

Negotiations over the capital gains tax rate will be interesting, as it is not clear that all Congressional Democrats are onboard with an increase that is as high as has been proposed, and there also appears to be an interaction with the proposal to tax gains at death, so that if that provision falls away, a rate that is lower than 39.6 percent may actually maximize the revenue available from a capital gains tax increase.[2]

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[1] *See* Richard Rubin, *Biden Budget Said to Assume Capital Gains Tax Rate Increase Started in Late April – 3rd Update,* www.morningstar.com/news/dow-jones/2021052712183 (May 27, 3021) (stating that a White House official previously said that the effective date for the capital gains provision would be designed with Congress to prevent taxpayers from taking advantage of any gap before the increase started).

[2] Bernie Becker, *Drilling Down on Cap Gains*, www.politico.com/newsletters/weekly-tax/2021/04/26/drilling-down-on-cap-gains-794887 (Apr. 26, 2021).

B. Corporations

As previously described in the American Jobs Plan, the Green Book proposes that the top tax rate on C corporations would increase from 21 to 28 percent. The increase in the corporate tax rate is proposed to take effect for taxable years beginning after December 31, 2021, although for taxable years beginning after January 1, 2021, and before January 1, 2022 (*i.e.*, taxable years that straddle 2021 and 2022), an additional seven percent rate would be charged for the portion of taxable income earned in 2022.

While people do not typically think of real estate as being held in corporate form, many real estate funds use C corporations to effectively "block" the flow-through of taxable income to tax-sensitive investors like non-U.S. and certain tax-exempt parties. The proposed increase in the corporate tax rate could materially affect the tax "leakage" associated with these blocker structures.

On the other hand, an increase in the C corporation tax rate together with an increase on the rate for qualified dividends could make investment in public REITs more attractive. Under current law, the effective rate on distributed corporate earnings (assuming a shareholder that is a U.S. citizen or resident) is approximately 39.8 percent.[3] By contrast, the effective rate on distributed REIT earnings for the same shareholder is approximately 33.4 percent.[4] The difference would change dramatically under the Green Book rates. If the Green Book provisions were adopted, the effective rate on distributed corporate earnings would increase to approximately 59.25 percent.[5] The effective rate on distributed REIT earnings would increase modestly to approximately 35.5 percent.[6]

Note that certain Congressional Democrats have expressed a belief that a 28 percent corporate tax rate is too high,[7] and President Biden has acknowledged publicly that, as part of a broader negotiation, he may be open to a corporate tax rate as low as 25 percent.[8]

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[3] Assume a corporation earns $100 and pays $21 of tax on those earnings. The remaining $79 that is distributed is then subject to tax at a rate of 23.8 percent (including the tax on net investment income ("NII")), which results in a tax of $18.80. Accordingly, of the $100 earnings, the shareholder retains $60.20.

[4] Assume a REIT earns $100 of ordinary income and pays $0 of tax on those earnings. Through the end of 2025, the $100 that is distributed is eligible for a 20 percent deduction under section 199A for purposes of calculating taxable income but not the 3.8 percent NII tax. So, $80 will be subject to tax at a rate of 37 percent ($29.60), and $100 will be subject to tax at a rate of 3.8 percent ($3.80), for a total tax of $33.40. Accordingly, of the $100 earnings, the shareholder retains $66.60.

[5] Assume a corporation earns $100 and pays $28 of tax on those earnings. The remaining $72 that is distributed is then subject to tax at a rate of 43.4 percent (including the tax on NII), which results in a tax of $31.25. Accordingly, of the $100 earnings, the shareholder retains $40.75.

[6] Assume a REIT earns $100 of ordinary income and pays $0 of tax on those earnings. Through the end of 2025, the $100 that is distributed is eligible for a 20 percent deduction under section 199A for purposes of calculating taxable income but not the 3.8 percent NII tax. So, $80 will be subject to tax at a rate of 39.6 percent ($31.68), and $100 will be subject to tax at a rate of 3.8 percent ($3.80), for a total tax of $35.48. Accordingly, of the $100 earnings, the shareholder retains $64.52.

[7] *See* Erik Wasson and Steven Dennis, *Manchin Balks at Biden's Corporate Tax Increase, Favors 25% Rate*, www.bloomberg.com/news/articles/2021-04-05/manchin-balks-at-biden-s-corporate-tax-increase-favors-25-rate (April 5, 2021).

[8] *See* Christina Wilkie, *Biden Open to 25% Corporate Tax Rate as Part of an Infrastructure Bill Compromise*, www.cnbc.com/2021/05/06/biden-says-corporate-tax-rate-should-be-between-25percent-and-28percent.html (May 6, 2021).

III. Carried Interest

The Green Book proposes to recharacterize income associated with “carried interest” as ordinary income for taxpayers who earn taxable income (from all sources) in excess of $400,000.

At a high level, the Green Book would apply ordinary income rates to income allocated with respect to an “investment services partnership interest” (an “ISPI”). Such income also would be subject to self-employment tax. In addition to recharacterizing allocated gain with respect to an ISPI, the provision would recharacterize as ordinary income, gain that is recognized upon the sale of an ISPI.

The provision allows some relief for service partners who contribute capital and receive allocations with respect to that capital that can be benchmarked to the allocations with respect to capital of other unrelated non-service partners. More specifically, the Green Book states: “[t]o the extent (1) the partner who holds an ISPI contributes ‘invested capital’ (which is generally money or other property) to the partnership, and (2) such partner’s invested capital is a qualified capital interest (which generally requires that (a) the partnership allocations to the invested capital be in the same manner as allocations to other capital interests held by partners who do not hold an ISPI and (b) the allocations to these non-ISPI holders are significant), income attributable to the invested capital would not be recharacterized.” The Green Book clarifies that “invested capital” would not include contributed capital that is attributable to proceeds of a loan or advance that is made or guaranteed by any partner or the partnership (or any person related to such persons).

The proposal describes an anti-abuse rule related to “disqualified interests” that would be intended to prevent the avoidance of the proposal through the use of compensatory arrangements other than partnership interests. The proposal also indicates a desire to avoid recharacterization of gain related to goodwill or other assets held by the business that are unrelated to the services of the ISPI holder (*i.e.*, enterprise value of the sponsor’s business as opposed to value attributable to the sponsor’s interests in investment funds).

The Green Book proposal would repeal section 1061[9] for taxpayers with taxable income (from all sources) in excess of $400,000[10] and would be effective for taxable years beginning after December 31, 2021.

Although light on details, the Green Book appears to follow the model for taxing carried interest that is embodied in the Carried Interest Fairness Act of 2021, which has been introduced in the House of Representatives by Rep. Bill Pascrell (NJ) and in the Senate by Sen. Tammy Baldwin (WI).[11] The rules

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[9] Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

[10] The Green Book implies that section 1061 would continue to apply to taxpayers with taxable income of $400,000 or less. While this presumably would be a small group of taxpayers, the reporting burden produced by continued application of section 1061 could be significant.

[11] H.R. 1068, 117th Cong. (2021). For a detailed discussion of earlier versions of the Carried Interest Fairness Act, which are substantively identical to the bill introduced in 2021, *see* James B. Sowell, *Levin Takes Another Shot at Carried Interest*, 148 Tax Notes 685 (Aug. 10, 2015); James B. Sowell, *Carried Interest: Line Drawing and Fairness (or Lack Thereof)*, 141 Tax Notes 617, 620-621 (Nov. 11, 2013) (Part 1); James B. Sowell, *Carried Interest: Line Drawing and Fairness (or Lack Thereof)*,

described in that bill are inordinately complex (statute is 44 pages), and the rules provide for results that extend well beyond character conversion—*e.g.*, override nonrecognition on many ISPI disposition transactions and distributions of property with respect to an ISPI, treat income allocated with respect to an ISPI as non-qualifying income for publicly-traded partnerships starting 10 years after the effective date, etc.[12]

Section 1061, which currently recharacterizes long-term capital gain related to carried interests in certain circumstances, exempts section 1231 gain and thereby excludes a significant portion of real estate capital gain from recharacterization. There is no indication that real estate would benefit from any exclusion from the carried interest provision described in the Green Book.[13]

IV. 3.8 Percent Medicare Tax

Under current law, a "limited partner" is not subject to self-employment tax on his or her allocable share of partnership income.[14] Also under current law, the 3.8 percent tax on net investment income ("NII") does not apply to income or gain from a trade or business activity in which the taxpayer actively participates (other than traders).[15] As relevant to the real estate industry, this provision generally exempts real estate professionals[16] from the 3.8 percent tax to the extent that they actively participate in a trade or business activity.[17]

The Green Book would significantly limit these exceptions to the self-employment and NII taxes. With respect to the NII tax, for taxpayers with adjusted gross income in excess of $400,000, the definition of NII would be amended to include gross income and gain from any trades or businesses so long as such gross income and gain is not subject to self-employment tax. If such an amendment were enacted, real estate professionals would cease to be exempt from the NII tax.

With regard to the self-employment tax, limited partners, LLC members, and S corporation shareholders who provide services and materially participate in the activities of the partnership, LLC, or S corporation would be subject to the self-employment tax to the extent that applicable income exceeds

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141 Tax Notes 721 (Nov. 18, 2013) (Part 2); and James B. Sowell, *Carried Interest: Line Drawing and Fairness (or Lack Thereof)*, 141 Tax Notes 857 (Nov. 25, 2013) (Part 3).

12 The Green Book states that the proposal is not intended to adversely affect qualification of a REIT owning a profits interest in a real estate partnership. This may be small consolation for a REIT whose operating partnership, if otherwise a publicly-traded partnership that relies on the "qualifying income" exception under section 7704(d), could be converted in 10 years to a C corporation under section 7704 if such income is non-qualifying income and sufficiently large to cause such a conversion.

13 It is important to recognize that Senate Finance Committee Chairman Ron Wyden (OR) has separately introduced the "Ending the Carried Interest Loophole Act" (S. 1639 – 2019), and that bill would take a very different approach to taxing carried interest as compared to the approach described in the Green Book. *See* James B. Sowell, *The Wyden Bill: A New Approach to Taxing Carried Interest*, https://assets.kpmg/content/dam/kpmg/us/pdf/2019/08/tnf-wnit-wyden-bill-aug26-2019.pdf (Aug. 26, 2019).

14 Section 1402(a)(13).

15 Section 1411(c)(2).

16 *See* section 469(c)(7); section 1.469-9.

17 Although rental activities generally are passive activities without regard to a taxpayer's level of participation, a real estate professional may actively participate in a rental activity assuming that the necessary rules for participation can be satisfied. Section 1.469-9(e).

certain threshold amounts.[18] As proposed, the rules for determining the amount of income that would be subject to the self-employment tax would be somewhat complicated. As an initial step, a taxpayer would calculate the sum of ordinary business income derived from limited partnerships, LLCs, and S corporations for which the taxpayer materially participates in the trade or business of the entity. This amount would be referred to as the "potential SECA income." The additional income that would be subject to self-employment tax would be the lesser of (1) the potential SECA income, and (2) the excess over $400,000 of the sum of the potential SECA income, wage income subject to FICA under current law, and 92.35 percent of self-employment income subject to the self-employment tax under current law. The formula appears intended to ensure that taxpayers with income subject to employment and/or self-employment tax of $400,000 or less (taking into account the deduction available for half of the self-employment tax other than the additional 0.9 percent Medicare portion applicable since 2013)[19] would not incur additional self-employment tax as a result of the change in law.

As described, application of the self-employment tax to limited partners, LLC members, and S corporation shareholders would depend on whether the person "materially participates" in the activity conducted by the entity. The Green Book does not specifically describe what would constitute material participation, although it does contain the following statements:

> Taxpayers are usually considered to materially participate in a business if they are involved in it in a regular, continuous, and substantial way. Often this means they work for the business for at least 500 hours per year.

At first blush, the emphasis on material participation for purposes of the self-employment tax would seem to encourage a grouping of activities so as to avoid material participation. Note, however, that income that escapes the self-employment tax under section 1402 generally will be subject to an equivalent tax imposed with respect to NII under section 1411.[20] There is a slight benefit to paying the self-employment tax rather than the NII tax, since a deduction is available for 1.45 percent of the of the 3.8 percent tax due.[21] No such deduction is available for the NII tax. The total amount of tax due also could be affected by the determination as to which bucket (*i.e.*, self-employment or NII) income or loss falls. The earning of a loss for purposes of the self-employment tax rules and income for purposes of the NII rules would result in more total tax than if all such income and loss was only self-employment income or only NII, since the loss then would be available to offset the earned income.

The proposal for the self-employment and NII taxes would be effective for taxable years beginning after December 31, 2021.

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[18] Rents, dividends, capital gains, and certain retired partner income would continue to be exempt from the self-employment tax without regard to amendments to the limited partner exception, but such income likely would become subject to the NII tax based upon the proposed amendment to that provision.

[19] Section 164(f).

[20] For taxpayers with self-employment income in excess of $400,000, the Social Security portion of the tax imposed under section 1401(a) at the rate of 12.4 percent would not apply. It is only the Medicare portion of the tax imposed under section 1401(b) that would apply, and that rate is an equivalent 3.8 percent .

[21] Section 164(f).

V. Like-Kind Exchanges

As part of the Tax Cuts and Jobs Act of 2017 ("TCJA"), section 1031 was repealed for exchanges of all property types except for real property. The Green Book would further limit the scope of section 1031, providing for nonrecognition of gain upon exchanges of real property only to the extent of $500,000 per taxpayer per year ($1 million in the case of married individuals filing a joint return).

The proposal states that gain in excess of the stated amount would be recognized by the taxpayer in the taxable year when the taxpayer transfers the real property subject to the exchange. Presumably this means that if a taxpayer were to engage in a deferred exchange that straddles two taxable years, the gain would be triggered in the first taxable year when the relinquished property is transferred rather than the second year when the exchange is completed. This treatment would represent a change from current law, since under current law gain recognized in a deferred exchange is determined under the installment method.[22]

The proposal would be effective for "exchanges completed in taxable years beginning after December 31, 2021." Under this effective date, if a taxpayer transferred relinquished property in deferred section 1031 exchange in 2021, but completed the section 1031 exchange by acquiring the replacement property in 2022, the proposal would force recognition of all gain in excess of the $500,000 amount (or $1 million for married individuals filing jointly). This obviously could put significant pressure on closing out all section 1031 exchanges by the end of 2021.

The effective repeal of section 1031 for real property exchanges would significantly affect a number of the "players" in the real estate industry. Public REITs generally pay dividends to eliminate their REIT taxable income, which includes net capital gain. If section 1031 is longer available to defer real property gains, public REITs may determine that they need to access the equity or debt markets to replenish some or all of the distributed proceeds related to real property gains. Otherwise, these REITs would face the possible choice of contraction through the sale of assets and distribution of gain proceeds or a need to re-raise capital it had only just distributed (and bear the costs related to raising that capital).[23] Admittedly, REITs are not required to distribute amounts attributable to net capital gain for purposes of the 90 percent distribution test,[24] and the REIT rules contain a mechanism whereby the REIT can pay tax on retained capital gains and allocate to its shareholders their share of the net capital gain together with what is essentially a credit for the taxes paid by the REIT.[25] On a historical basis, utilization of this rule by public REITs has been extremely rare due to the complexity to shareholders and the fact that many public REIT shareholders are domestic and foreign institutional investors who pay U.S. income tax at a rate that is lower than the regular corporate income tax rate. The lack of a mechanism that

[22] Section 453(f)(6).

[23] In addition to the obvious point that many public REIT would prefer to expand their asset base rather than shrinking in size, a contraction in a REIT's asset base could have other effects, including reducing the REIT's ability to borrow under a line of credit.

[24] Section 857(a)(1)(A).

[25] Section 857(b)(3)(C).

would provide shareholders a credit for state and local income taxes paid by a REIT also may be a problem. REITs may consider paying "stock/cash election" dividends to preserve liquidity,[26] although meaningful commercial obstacles could discourage such action.[27]

Many open-end real estate funds also utilize section 1031 to defer gain. A typical open-end real estate fund owns most, if not all, of its real estate assets through a lower-tier REIT. By holding property in a REIT, it generally is not feasible to isolate existing gain in the assets of a mature fund to pre-existing investors when a new investor is admitted.[28] In order to prevent these new investors from bearing what is essentially phantom taxable income, open-end funds often will attempt to defer gain recognized on the sale of real property by entering into a section 1031 exchange.

There also are entire industries whose business model relies upon the availability of tax-free like-kind exchanges. As one example, there is the "TIC" exchange industry, whereby a sponsor will divide a property with a high-quality tenant paying stable rent pursuant to a long-term lease into separate tenants-in-common interests that are available as replacement property for smaller-scale investors who would like to sell their property and acquire in a deferred exchange property providing a constant and predictable income stream. It is likely that the limitation of nonrecognition treatment to $500,000 of gain on an annual basis would significantly shrink the activity undertaken by the TIC industry.

Finally, there is likely to be a significant "lock-up" effect that would come with the effective elimination of section 1031 for real property. Without the ability to defer gain, many taxpayers will simply decide not to sell, at least for a time. In many instances, this will prevent the acquisition of property by parties who would develop property to its highest and best use. And the implications are broader. For example, without the transfer of property, certain states and municipalities will not receive transfer taxes and recording fees in connection with the sale, and the property will not be revalued for property tax purposes by reference to the transfer value.

If the section 1031 proposal is enacted, property owners may express greater interest in other nonrecognition transactions such as mixing-bowl partnership transactions,[29] utilization of tracking

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[26] *See* Rev. Proc. 2017-45, 2017-35 I.R.B. 216.

[27] REIT shareholders often expect a certain level of dividends on a share of stock, and to the extent the distribution of stock dividends puts additional stock into the hands of shareholders, the expectation for the future total payment of dividends may increase unless the REIT immediately implements a reverse stock split to neutralize the effect of such stock dividend distribution.

[28] While reverse section 704(c) gain resulting from a revaluation of assets can isolate gain to partners in this way for assets held by a partnership, in an open-end fund where assets are held through a lower-tier REIT, the applicable rules do not support pushing a reverse section 704(c) layer created by a revaluation of partnership assets through to the assets of a REIT.

[29] In a mixing-bowl transaction, partners contribute different properties to a partnership in anticipation of receiving a distribution of the other partner's contributed property more than seven years after the date of contribution. *See* sections 704(c)(1)(B) and 737.

interests in connection with partnership formation transactions,[30] UPREIT "unit deals," or leveraged partnerships[31] to take advantage of deferral but obtain exposure to other desired real estate assets.

Taxpayers may encounter complexities, or potentially opportunity, in determining the impact of gain recognized for federal purposes on their state income tax bases in different states, because certain states would not automatically conform to a federal change made to section 1031. For these "static conformity" states, unless an adjustment is made to state law in order to follow the federal change, the version of the Code adopted by this category of state would continue to apply without a nonrecognition cap of $500,000 per taxpayer per year. If a taxpayer is located in a different state than the state where the exchanged property is located, then the taxpayer would need to consider Code conformity in both the state where the taxpayer is located and in the state where the property is located in order to determine if gain is recognized for state income tax purposes.

VI. Excess Business Losses

As enacted under the TCJA, for taxpayers other than C corporations, "excess business losses"[32] are not allowed as a deduction in the current year but instead are carried over as part of a taxpayer's net operating loss.[33] In effect, this rule limits the ability of non-C corporation taxpayers to deduct (in the year recognized) business losses in excess of a threshold amount (*e.g.*, $500,000 for married individuals filing jointly, adjusted for inflation) against other income, like wages and investment income.

As originally enacted, the provision was to be effective for taxable years beginning after December 31, 2017, and before January 1, 2026. This provision was suspended for a period under the Coronavirus Aid and Economic Security Act but is now effective and was extended for an additional year under the American Rescue Plan Act of 2021 ("ARPA").

Under the Green Book, the limitation on excess business losses would be made permanent.

The state tax impact of the proposed change to the excess business loss rules will vary across different states, depending on how a state follows changes made to the Code. A state that adopts a fixed, prior version of the Code may continue to limit excess business losses even if it has not yet updated its conformity for the current proposal. This limitation would be based on conformity to the TCJA or to the ARPA, so would sunset after December 31, 2025, or after December 31, 2026, depending on which federal rules the state has adopted, if the state has not made changes to adopt a permanent limitation by the applicable sunset date. During the time that the excess business losses remains limited, the

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30 Under such structures, partners contributing different assets might create tracking interests so that they share disproportionately in the other partner's contributed asset. *Cf.* section 1.704-4(f)(2), Ex. 1 (illustrating anti-mixing bowl anti-abuse rule and the implications of tracking interests).

31 *See* section 1.707-5(b); *Canal Corp. v. Commissioner*, 135 T.C. 199 (2010). The goal of such a transaction would be to monetize existing real estate on a tax-deferred basis and reduce one's exposure to such assets, while using the cash received to invest in other real estate.

32 For purposes of these rules, an "excess business loss" for a married individual filing jointly equals (1) the aggregate deductions of a taxpayer attributable to all trades or businesses over (2) all business income and gain of the taxpayer plus $500,000 (adjusted for inflation). The limitation amount is $250,000 for individual taxpayers. Section 461(l)(3).

33 Section 461(l).

overall impact of the limitation in a particular state would depend on the net operating loss rules used by that state, including that state's carryforward period or any limitation or suspension on the use of net operating losses for certain taxable years.

VII. Tax Gain on Assets at Death, upon Gifting, and Other Events

A. At Death and upon Gifting

As expected, the Green Book contains a proposal that generally would tax asset appreciation transferred by gift or upon death.[34] Capital losses (including carryforwards) would be allowed to offset capital gains recognized at death.[35] Taxes on gains recognized at death would be allowed as a deduction on the decedent's estate tax return.[36]

The proposal exempts transfers to certain persons for purposes of the gain recognition rule. Specifically, no gain would be recognized upon the transfer of property to a surviving spouse (who would take a carryover basis),[37] and no gain would be recognized upon the donation of appreciated property to a charity.

The Green Book proposal also provides an exclusion for gain on tangible personal property (*e.g.*, household furnishings and personal effects, but excluding collectibles). The current-law exclusion for capital gain on a principal residence (*i.e.*, $250,000 per person) is incorporated into the proposal and would be portable to the decedent's surviving spouse (making the exclusion effectively $500,000 for married individuals). The proposal also mentions application of the exclusion for certain small business stock.

The proposal would allow a $1 million per person exclusion for other unrealized gains on property transferred by gift or held at death. This lifetime exclusion would be indexed for inflation and would be portable to a surviving spouse (making the exclusion $2 million per married couple). The proposal seems to imply that property subject to the exclusion would be stepped up to a fair market value basis if transferred upon death, but carryover basis would apply to gifted property to the extent subject to the exclusion.

With regard to illiquid assets, the proposal would incorporate two relief provisions. Under the first, tax would not be due upon the bequest or gifting of certain family-owned and -operated businesses, and instead, the tax would become due when the business is sold or ceases to be family-owned and -operated. Under the second, the tax on illiquid assets (excluding assets related to family-owned and -operated business subject to the first exception) transferred at death could be paid over a 15-year fixed payment plan.

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[34] Proposed legislation to tax gains on assets that are gifted or transferred upon death was introduced earlier in 2021. *See* H.R. 2286, 117th Cong. (2021). While the details of that bill are not identical to the Green Book proposal, there are a number of similarities.

[35] Capital losses also could offset up to $3,000 ordinary income on the decedent's final return.

[36] The Green Book does not comment on the deductibility of such taxes on a donor's gift tax return.

[37] The Green Book does not mention gifts to a spouse as being exempt, although this may be an oversight.

Obviously, the current rules providing for a step-up in asset basis at death encourage many individual taxpayers to hold real property until death. These rules also may affect decisions made by large real estate partnerships when one or more partners have significant gain with respect to assets held by such partnerships. While this proposal is among the most controversial in the Green Book, if enacted, it could change behavior significantly regarding decisions to sell assets.

B. Transfers by Non-Corporate Entities

The Green Book contains the following statement: "[T]ransfers of property into, and distributions of property in kind from, a trust, partnership, or other non-corporate entity, other than a grantor trust that is deemed to be wholly owned and revocable by the donor, would be recognition events." At first blush, the statement would seem to create great concern, as it appears to indicate an intention to override the nonrecognition provisions—sections 721 and 731—applicable to partnership contributions and distributions. This statement is made following statements indicating that a "transfer" for purposes of the gain recognition provision relevant to gifts and bequests generally would be defined under the estate and gift provisions, but that certain special rules would apply. Read in context, it appears that the provision would be intended to apply only when the contribution or distribution would result in a gift under the estate and gift tax provisions.[38]

C. 90-Year Assets

The Green Book contains an additional proposal that was somewhat unexpected, given that it was not described in the fact sheet issued in connection with the American Families Act.[39] This proposal would require unrealized gain in assets owned by a trust, partnership, or other non-corporate entity to be recognized if the property has not been the subject of a recognition event within the prior 90 years. Testing for the 90-year holding period would be for periods beginning January 1, 1940. As a result, a recognition event could not occur until December 31, 2030.[40]

Under the Green Book, it is unclear to what extent a number of the exemptions and exclusions to the gain recognition provision applicable to gifts and/or bequests also might apply to this 90-year rule. It would seem rational that the rule delaying payment with respect to family-owned and -operated business could apply, and the ability to use a 15-year fixed-payment plan for gain on illiquid assets may be available (although the description references application of the fixed-payment plan only to the tax on appreciated assets transferred at death).

Real estate is often passed within a family from generation to generation, so this provision could have a significant impact on such family-held assets. In addition, the proposal would appear to require

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[38] For example, assume that A and B form a 50-50 partnership, with A contributing $100 and B contributing property with a basis of $0 and value of $1 million. Obviously, B has made a transfer of value to A in connection with the formation of this partnership, and the appreciation associated with that shifted value would be subject to tax under the proposal.

[39] Other proposals have been introduced in Congress that would treat certain properties held in trust for an extended period of time as deemed transferred for purposes of triggering tax on appreciation related to such assets. *See, e.g.*, H.R. 2286, 117th Cong. (2021) (property held in trust for 30 years without triggering a deemed sale upon gift or death is deemed transferred).

[40] The initial gain recognition date of December 31, 2030, would occur within the 10-year budget window, thus presumably generating significant tax revenue for purposes of the 10-year score.

recognition of an asset’s unrealized appreciation that has not been the subject of a recognition event during the prior 90 years regardless of whether the impacted entity itself has held the property for 90 years. This could raise due diligence concerns in connection with tax-deferred acquisitions, including contributions to a partnership, such as an UPREIT operating partnership.

The impact of a change on a taxpayer’s state income tax liabilities may depend on how the gain recognition is achieved for federal income tax purposes. Most states utilize federal taxable income or federal adjusted gross income as the starting point for computing the state tax base. If those federal values include recognition of additional gains, then a state tax base would also include these values, as long as that state maintains or has adjusted its conformity to follow the version of the Code that includes this provision.

D. Effective Date

These proposals would be effective for gains on property transferred by gift, and on property owned at death by decedents dying, after December 31, 2021, and on certain properties owned by trusts, partnerships, and other non-corporate entities on January 1, 2022.

VIII. International Provisions

A. SHIELD

The administration’s proposal would repeal the base erosion and anti-abuse tax (“BEAT”) imposed by section 59A and replace it with the “stopping harmful inversions and low-tax developments” (“SHIELD”) rule for taxable years beginning after December 31, 2022. SHIELD would disallow deductions to domestic corporations or U.S. branches of foreign corporations by reference to low-taxed income of entities that are members of the same financial reporting group, as defined below. The BEAT has had limited application to real estate investors, but SHIELD could have a significant impact on foreign-controlled U.S. blocker corporations and REITs.

The BEAT generally applies only to corporate taxpayers that are part of an aggregate group that has average annual *U.S.* gross receipts of at least $500 million for the prior three years and a base erosion percentage for the year of at least three percent (or in some cases two percent). While a relatively small number of U.S. blocker corporations that are majority owned (greater than 50 percent vote or value) by a large foreign institutional or government investor have been subject to BEAT, most foreign controlled U.S. blockers have been outside the scope of BEAT because of the high U.S. gross receipts thresholds. Additionally, REITs by definition are not BEAT taxpayers, but BEAT may apply to payments from a TRS to a REIT in certain structures, particularly involving REITs operating in the hospitality and health care industries.

SHIELD, on the other hand, would apply to any “financial reporting group” that (1) includes at least one domestic corporation, domestic partnership, or foreign entity with a U.S. trade or business and (2) has more than $500 million in *global* annual revenues, as determined based on the group’s consolidated financial statement. A financial reporting group, for these purposes, would be any group of business entities that prepares consolidated financial statements in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”), International Financial Reporting Standards (“IFRS”), or another method authorized by regulations. The elimination of the base erosion percentage threshold and focus on global revenues rather than U.S. revenues would significantly broaden the scope of taxpayers subject to SHIELD and would cause a significant number of foreign owned U.S. blocker corporations that have avoided BEAT to be subject to SHIELD. Additionally, as discussed in greater detail below, the lack of a specific carve-out for REITs could result in SHIELD applying to payments made by REITs that would not have been relevant for purposes of calculating BEAT.

If a domestic corporation or branch is a member of a financial reporting group, SHIELD would disallow certain deductions when both of the following conditions are satisfied: (1) the financial reporting group contains one or more "low taxed members" and (2) the domestic corporation or branch makes any gross payment to a member of the financial reporting group. For purposes of SHIELD, a "low-taxed" member is any financial reporting group member whose income is subject to (or deemed subject to) an effective tax rate (the "SHIELD ETR") that is below a "designated minimum tax rate." The "designated minimum tax rate" would be the rate agreed under "Pillar Two" of the OECD's base erosion project (*i.e.*, by multi-lateral agreement). If, however, SHIELD is in effect before an international agreement on Pillar Two is reached, the designated minimum rate would be the proposed rate for GILTI (21 percent).[41]

It appears that a member's SHIELD ETR would be computed by aggregating the income earned and the taxes paid or accrued with respect to that income by all financial reporting group members on a jurisdiction-by-jurisdiction basis, rather than on an entity-by-entity basis. If a domestic corporation makes a payment (*e.g.*, interest) directly to a low-taxed member of the group, the payment would be subject to SHIELD in its entirety and would result in the denial of deductions to the U.S. corporation in an amount equal to the amount of the payment. Additionally, even if the payment is not made directly to a low-taxed member, as long the group has at least one low-taxed member, any *gross* payment by a domestic corporation or branch to *any* other member of the same financial reporting group (including the common foreign parent of any foreign-parented controlled group) generally would trigger a disallowance of some amount of deductions to the domestic corporation or branch.

Large foreign pension funds and foreign governments routinely invest in real estate funds through wholly owned U.S. blocker corporations that they fund with debt and equity. Foreign pension funds and foreign governments typically are not subject to income tax (or are subject to a low rate of tax) in their home countries and, thus, presumably would not meet the SHIELD ETR threshold. Thus, absent an exception, if a U.S. blocker corporation is included in the same financial reporting group as its foreign pension fund or foreign government owner (and the group meets the applicable revenue threshold), interest that the U.S. blocker pays to its foreign pension fund or foreign government owner could be subject to SHIELD in its entirety, resulting in a corresponding disallowance of deductions to the blocker. While the proposal includes regulatory authority to exempt payments to certain investors, including investment funds, pension funds, and tax-exempt entities—and potentially also foreign government investors, although not expressly stated—the regulatory process takes time. It also is not entirely clear how those exceptions might apply.

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41 Changes to the GILTI rate and regime are discussed below at section VIII.C.

In addition to the potential impact on U.S. blocker corporations, the SHIELD could have a broader application to REITs and their affiliates than does the BEAT. REITs are exempt from the application of the BEAT as a payor. However, under the BEAT regulations, a REIT is a "specified domestic passthrough" and, as such, payments made by entities which are subject to the BEAT, such as a REIT's taxable REIT subsidiaries, can be taken into account for purposes of calculating BEAT liability for those entities. As mentioned above, this primarily has been an issue for REITs in the hospitality and health care industries, whose C corporation subsidiaries often make significant, otherwise deductible rent payments to the REIT.

Under the proposal, by contrast, it appears that a REIT itself could be a member of a SHIELD "financial reporting group." The inclusion of the REIT in the financial reporting group may be important, because deductible payments made by a REIT might include not only expenses deductible by a typical taxpayer, such as interest expense, but also dividends paid by the REIT. As noted above, while the proposal would provide regulatory authority to exempt payments to certain types of investors, it is not yet clear the extent to which these exemptions, if put into place, would apply to REITs. In addition, it is not entirely clear the extent to which otherwise-deductible payments between domestic entities (such as rent and interest paid by to a REIT by its C corporation subsidiaries) would be subject to the SHIELD. As mentioned above, the BEAT treats REITs as a conduit in certain circumstances with respect to deductible payments made to it its C corporation subsidiaries.

B. Limitation on Interest Deductions for Members of Certain Multinational Groups

The Green Book includes a second proposal that could limit the deductibility of interest expense incurred by a U.S. blocker corporation or REIT if the taxpayer is a member of a multinational group and is considered to have disproportionate net interest expense as compared to the rest of the group. The proposal appears targeted at earnings stripping concerns with respect to U.S. subsidiaries of foreign-parented groups, and would apply only to members of multinational "financial reporting groups," as defined in the same manner as for SHIELD purposes, discussed above.

Under the proposal, a member's interest deduction for U.S. tax purposes (both with respect to related and unrelated party debt) would be limited if the member's net interest expense for financial reporting purposes (computed on a separate company basis) exceeds the member's proportionate share of the financial reporting group's net interest expense reported on the group's consolidated financial statements (such excess would be defined as "excess financial statement net interest expense"). A member's proportionate share of the financial reporting group's net interest expense would be determined based on the member's proportionate share of the group's earnings (computed by adding back net interest expense, tax expense, depreciation, depletion, and amortization (*i.e.*, EBITDA)) reflected in the financial reporting group's consolidated financial statements. Unlike SHIELD, this proposal could apply to limit the interest deductions of a U.S. blocker corporation or REIT regardless of whether the taxpayer pays interest or makes any payments to other members of its financial reporting group.

The proposal largely follows prior Obama Administration Green Book proposals and also is consistent with the OECD BEPS, Action 4 Report (Limiting Base Erosion Involving Interest Deductions and Other

Financial Payments). The proposal differs significantly, however, from the proposed section 163(n) that was considered, but ultimately rejected, as part of the legislative process for the TCJA. The Senate version of proposed section 163(n) would have focused on debt-equity ratios rather than EBITDA.

If a member has “excess financial statement net interest expense,” a deduction would be disallowed for the member’s “excess net interest expense” for U.S. tax purposes. The member’s “excess net interest expense” equals the member’s net interest expense for U.S. tax purposes multiplied by the ratio of the member's “excess financial statement net interest expense” to the member’s net interest expense for financial reporting purposes. If a member’s net interest expense for financial reporting purposes is less than the member’s proportionate share of the net interest expense reported on the group’s consolidated financial statements, such excess limitation would be converted into a proportionate amount of excess limitation for U.S. tax purposes and carried forward.

If a financial reporting group member fails to substantiate its proportionate share of the group’s net interest expense for financial reporting purposes, or a member so elects, the member’s interest deduction would be limited to the member’s interest income plus 10 percent of the member’s adjusted taxable income (as defined under section 163(j)).

This proposal would operate concurrently with section 163(j), such that the amount of interest expense a taxpayer could deduct in a taxable year would be limited by the more restrictive of the two limitations in that year. Foreign corporations that engage in a U.S. trade or business directly or through a partnership generally determine interest expense allocable to that U.S. trade or business pursuant to the rules of section 1.882-5 of the regulations. It is not clear how this proposal would interact with those rules.

The proposal would not apply to financial services entities, and such entities would be excluded from the financial reporting group for purposes of applying the proposal to other members of the financial reporting group. The proposal also would not apply to financial reporting groups that would otherwise report less than $5 million of net interest expense, in the aggregate, on their U.S. income tax returns for a taxable year.

The Green Book also does not address the treatment of partnerships. Rather, the Green Book states that Treasury would be given broad regulatory authority for implementation, including the treatment of partnerships.[42] The proposal would apply to taxable years beginning after December 31, 2021.

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[42] The Green Book states regulatory authority would include: (i) coordinating the application of the proposal with other interest deductibility rules, including the SHIELD, (ii) defining interest and financial services entities, (iii) permitting financial reporting groups to apply the proportionate share approach using the group’s net interest expense for U.S. tax purposes rather than the net interest expense reported in the financial statements, (iv) providing for the treatment of pass-through entities, (v) adjusting the application of the proposal to address differences in the functional currency of members, (vi) providing for the allocation of a U.S. subgroup’s excess net interest expense among the members if they are not all members of a single U.S. consolidated group, and (vii) addressing structures with a principal purpose to limit the application of the proposal.

C. Revise the Global Minimum Tax Regime

The Green Book contains several reforms aimed at ensuring a U.S. taxpayer’s global income is subject to a minimum rate of tax. These reforms would be implemented primarily through modifications to the operation of the current “global intangible low-taxed income” (“GILTI”) regime and through the expansion of section 265, which generally disallows deductions that are attributable to income exempt from U.S. federal income tax.

Section 951A, commonly referred to as the GILTI regime, requires a U.S. shareholder of a controlled foreign corporation (“CFC”) to include the CFC’s tested income currently in its gross income regardless of whether the CFC actually distributes the income. Under current law, the computation of a U.S. shareholder’s GILTI inclusion is made on an aggregate basis across all of its CFCs by reducing the U.S. shareholder’s pro rata share of CFC tested income by its pro rata share of CFC tested losses. A taxpayer’s GILTI inclusion also may be reduced by its net deemed tangible income return, which generally is 10 percent of a CFC’s “qualified business asset investment” (“QBAI”), reduced by certain interest expense. Further, corporate U.S. shareholders currently are allowed a deduction pursuant to section 250 equal to 50 percent of their GILTI inclusion, subject to an overall taxable income limitation.

A U.S. corporate shareholder (or an individual that has made a section 962 election) generally may elect to claim a foreign tax credit (“FTC”) for 80 percent of the foreign income taxes that it is deemed to pay pursuant to section 960(d) with respect to its CFCs’ tested income. Because a taxpayer’s FTC limitation is currently calculated under section 904(d) on an aggregate basis with respect to all of its income in the GILTI basket, a taxpayer may use foreign taxes deemed paid by it in a high-tax jurisdiction to offset residual U.S. income tax on tested income earned by a CFC in a jurisdiction with a lower effective tax rate (referred to as “cross-crediting”).

The Green Book proposal would eliminate QBAI and reduce a corporate U.S. shareholder’s section 250 deduction with respect to its GILTI inclusion from 50 percent to 25 percent. The combination of increasing the corporate tax rate to 28 percent and decreasing the section 250 deduction to 25 percent would result in a doubling of the U.S. effective tax rate on GILTI from 10.5 percent under current law to 21 percent under the proposal. Further, it appears that the “20 percent haircut” for foreign income taxes deemed paid with respect to a GILTI inclusion would continue to apply which, when combined with the changes mentioned above, means that a CFC would be required to pay foreign income taxes on its tested income at an effective rate of 26.25 percent to eliminate any residual U.S. tax on the U.S. shareholder’s GILTI inclusion (determined without regard to U.S. expense allocation and apportionment).

The Green Book proposal also would make significant structural changes to the GILTI regime that would require U.S. shareholders to compute their GILTI inclusion on a “jurisdiction-by-jurisdiction” basis. Under the proposal, a U.S. shareholder would be required to compute its GILTI inclusion and U.S. federal income tax on such inclusion separately for each jurisdiction in which its CFCs have operations. The U.S. shareholder also would also be required to compute a separate GILTI FTC limitation for each such jurisdiction, thereby precluding the ability to cross-credit its foreign income taxes deemed paid in respect of its GILTI inclusion. In connection with the move to a jurisdiction-by-jurisdiction calculation, the proposal also would repeal the high tax exception for subpart F and GILTI.

The proposal also would apply a similar jurisdiction-by-jurisdiction FTC limitation with respect to a taxpayer's foreign branch basket income, although the proposal does not appear to apply a jurisdiction-by-jurisdiction approach with respect to the calculation of taxable income from a foreign branch. Interestingly, the proposal would not make any changes to the subpart F regime other than repealing the high-tax exception, thereby allowing taxpayers to continue to cross-credit foreign taxes deemed paid as a result of subpart F inclusions with respect to CFCs in different jurisdictions.

Although not explicitly addressed in the Green Book, the administration's proposal to compute GILTI on a jurisdictional basis would seemingly prevent tested losses incurred in one jurisdiction from reducing tested income earned in another jurisdiction. Absent rules that would allow the carryforward of an unused tested loss—which is not allowed under current law—U.S. shareholders would often be unable to appropriately use the economic losses of CFCs. The Green Book's jurisdiction-by-jurisdiction FTC limitation proposal also could increase the chances for a taxpayer to permanently lose GILTI foreign tax credits.

Additionally, the proposal would make changes to the incredibly complicated expense allocation and apportionment rules that could adversely affect a taxpayer's U.S. tax liability and FTC limitation calculations, including expanding the application of section 265 to disallow deductions that are allocable to income that is effectively exempt from U.S. tax (*e.g.*, CFC dividends that are eligible for the section 245A deduction) or subject to U.S. tax at a preferential rate through a deduction (*e.g.*, GILTI that is eligible for the section 250 deduction). In connection with these changes, the proposal would repeal section 904(b)(4).

The Green Book proposals described above are each proposed to be effective for taxable years beginning after December 31, 2021.

IX. Tax Credits

A. Housing Tax Credits

1. Expansion of Low-Income Housing Tax Credit

The Green Book describes a proposal to create an additional type of low-income housing credit dollar amount ("HCDA") allocated to each state, the District of Columbia, and each U.S. territory, (collectively "State") called the opportunity housing credit dollar amount ("OHCDA"). State housing credit agencies ("HCAs") would have a separate ceiling for OHCDAs from their existing allocation ceilings of HCDAs. The introduction of OHCDAs would have no impact on the allocation and ceilings for HCDAs.

HCAs would be required to allocate the majority of their OHCDAs to projects in Census Tracts of Opportunity ("CTOs") (*i.e.*, a tract entirely in one or more difficult to develop areas ("DDAs")[43] or which has low poverty or other advantages as determined by the Secretary of the Treasury in consultation with the Housing and Urban Development ("HUD")). For each calendar year from 2022 through 2026,

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[43] A DDA is an area designated by HUD as an area that has high construction, land, or utility costs relative to area median gross income.

new OHCDAs would equal 118 percent of the aggregate annual number of new HCDAs provided under current law. The additional OHCDAs would be allocated among the States on a per capita basis, but a different per capita amount would be applied to each State. The per capita amount for a State would be determined by a formula established by the Treasury Secretary in consultation with HUD. This formula is intended to provide higher amounts to States with higher costs of constructing and operating affordable housing (*i.e.*, larger populations living in DDAs or higher percentages of rent-burdened households).

The proposal states that buildings in DDAs that receive allocations of either HCDAs or OHCDAs would receive an increase in eligible basis for the relevant credit (commonly called "basis boost") of up to 50 percent.

The proposal would be effective for calendar years beginning in 2022.

2. New Neighborhood Homes Investment Tax Credit

The Green Book contains an additional proposal that would create a new tax credit—the Neighborhood Homes Investment Credit ("NHIC"). This credit is intended to support new construction for sale, substantial rehabilitation for sale, and substantial rehabilitation for existing homeowners. In order to qualify for the credit, the constructed or rehabilitated residence must be a single-family home (including homes with up to four dwelling units), a condominium, or a residence in a housing cooperative.

NHICs would be allocated to States for calendar years 2022 through 2031. Available NHICs for 2022 would be $2 billion, and that amount would be indexed for inflation for years 2023 to 2031. The proposal does not clearly define rules for the allocation of available credits but instead delegates to the Treasury Secretary the authority to establish rules to divide the potential NHICs among the States; identify distressed neighborhoods; and establish criteria for which NHICs may be earned in certain additional rural communities and/or in gentrifying census tracts for owner-occupied rehabilitation.

Each State would create a new agency (or identify a pre-existing agency) to serve as the Neighborhood Homes Credit Agency ("NHCA"), with authority to allocate potential NHICs to project sponsors, and sponsors seeking potential NHICs would apply on a competitive basis. Each NHCA would establish a qualified allocation plan ("QAP") to serve as a guidepost in allocating NIHCs among competing proposals.[44]

Taxpayers would be eligible to claim NHICs only after construction, inspection, and owner occupancy. For homes that are to be sold to a qualifying new purchasing owner-occupant, the credit would be claimed when that owner-occupant begins residence. In the case of continuing qualifying owner-

[44] QAPs would require assessments of (1) neighborhood need for new or rehabilitated homes, (2) neighborhood revitalization strategy and impact, (3) sponsor capability, and (4) likely long-term homeownership sustainability. There would be a preference for proposals that would further fair housing purposes, as described in 42 USC, Chapter 45, Subchapter I and as interpreted by HUD. The proposed statute also would require that non-profit sponsors would receive at least 10 percent of potential-NHIC allocations made each year.

occupants who rehabilitate their homes, the credit would be claimed when construction has been completed and inspected, and the owner-occupant is in residence.

Taxpayers could claim the NHIC only if the owner-occupant after construction of rehabilitation is a "NHIC-Qualified Owner." An NHIC-Qualified Owner would be an owner/occupant whose household income does not exceed 140 percent of area/State median income, adjusting for household size as determined by HUD.

In general, the amount of the credit would equal development costs less the sales price, or, in the case of a homeowner rehabilitation, less the amounts paid by the homeowners for the residence. The amount that could be claimed, however, would be subject to several limits.[45]

The NHIC is potentially subject to recapture. If within five years from the date of qualification for the NHIC, the purchasing or rehabilitating owner/occupant ceases to be the residence's owner occupant (*i.e.*, the residence is sold or exchanged), a portion of the NHIC would have to be repaid.

This proposal would apply to allocations of NHICs in calendar years after 2021. Credits could be claimed in taxable years ending after December 31, 2021.

B. Energy Tax Credits

The Green Book also contains a number of proposals that are designed to incentivize clean energy or energy efficiency. Some of these proposals may be relevant for the real estate industry.

For example, currently, a taxpayer may claim an investment tax credit ("ITC") equal to 26 percent of the cost of certain energy property. For a solar photovoltaic system installed on the rooftop of a commercial rental building, the credit is subject to phasedown *(i.e.*, 22 percent for the system commencing construction in 2023 and placed in service before 2026 and 10 percent for any system placed in service after 2025). One of the proposals under the Green Book would restore the credit to the full 30 percent rate for eligible property that begins construction after December 31, 2021, and before January 1, 2027. After 2026, the credit rate would begin to phase down to zero over five years. This particular proposal would also allow taxpayers to elect a cash payment in lieu of the business tax credits (*i.e.*, a direct pay option).

Some of the clean-energy proposals under the Green Book are similar to the proposals under the Clean Energy for America Act ("Clean Energy Bill") reintroduced by Senate Finance Committee Chairman Ron Wyden on April 21, 2021, and passed out of the Committee on May 26, 2021. As one example, the Green Book and the Clean Energy Bill both would restore and enhance the ITC provisions related to

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[45] The proposal includes certain principles that would be used in determining the amount of credit, including: (1) Necessity: When sales proceeds meet or exceed development costs, no credit may be claimed; (2) Limited subsidy: The credit may not exceed 35 percent of the lesser of: (i) development costs or (ii) 80 percent of the national median sales price for new homes, nor may it exceed the excess of development costs over sales proceeds; (3) Skin in the game: The taxpayer must have an incentive to sell the residence for a higher sales price; and (4) No cliffs: There is no point at which an additional dollar of sales proceeds can precipitously reduce the credit to zero. Instead, the credit phases out such that it reaches zero at the maximum amount of permitted sales proceeds.

renewable and alternative energy. Also similar to the Green Book, the Clean Energy Bill would allow a taxpayer to elect a direct-pay option to receive cash in lieu of the ITC under the proposed provisions described in the prior sentence.

With respect to the direct-pay option, the Clean Energy Bill, as modified by the Chairman's Mark, clarifies "that, notwithstanding the retained taxable income rule, REITs can elect and receive direct payments of those credits in the Chairman's Mark that provide for such direct payment elections."[46] The Green Book does not describe such a clarification, and it is unclear whether such a clarification might be intended. This clarification in the Chairman's Mark to the Clean Energy Bill is meaningful. A REIT's ITC ordinarily is reduced in proportion to the REIT's taxable income that is distributed to its shareholders. Because a REIT ordinarily will distribute all of its taxable income, its ability to use ITC to subsidize an ITC-eligible investment is significantly limited. The elimination of this retained income rule would facilitate the receipt of cash payments by a REIT (in lieu of credits that a REIT cannot pass through and hence are of little value), such that a REIT would be incentivized to make more clean-energy investments without complicated structuring.[47]

X. Tax Procedure

Although not targeted at real estate, the Green Book contains a number of proposals that would affect tax reporting with respect to real estate. One proposal would increase funding to the IRS to bolster enforcement and compliance activities. According to the Green Book, "[t]he proposal would direct that additional resources go toward enforcement against those with the highest incomes, rather than Americans with actual income of less than $400,000."

A separate proposal would create a comprehensive financial account information reporting regime that would require financial institutions to report data on financial accounts in an information return. The annual return provided by financial institutions would report gross inflows and outflows (including a breakdown for physical cash), transactions with a foreign account, and transfers to and from another account with the same owner.

The Green Book also contains a proposal addressing the quality of paid tax return preparers. The Treasury Secretary would be delegated explicit authority to regulate all paid preparers of tax returns, including by establishing mandatory minimum competency standards.

Another proposal would expand the scope of returns that are subject to required electronic filing, and the backup withholding regime would be modified such that the IRS would be permitted to require payees of any reportable payments to furnish their TINs to payors under penalties of perjury.

Additional proposals would expand broker reporting for crypto assets, extend the statute of limitations for "listed transactions," make a narrow, but favorable, change to the partnership audit rules (to facilitate

[46] *Description of the Chairman's Modification to the Provisions of the Clean Energy for America Act*, JCX-28-21 (May 26, 2021).

[47] Currently, many REITs use their taxable REIT subsidiaries to hold eligible energy property for purposes of claiming ITCs, which may require REITs to lease certain property (such as rooftop areas) to the taxable REIT subsidiaries and to ensure certain profits subject to tax and to utilize the ITC.

refunds from favorable adjustments in connection with "push-out" elections), and address the approval process within the IRS for imposing penalties on a taxpayer.

XI. What Is Not Included?

While there is little good news in the proposals described above, there are certain proposals discussed during Biden's campaign that were not included in the Green Book. For example, the Green Book proposes no tax on large financial institutions, no phase out of section 199A, no reduction in the estate tax exemption, and no cap on itemized deductions. This is not to say that these items will be off the table as Congress searches for revenue to offset spending provisions that are proposed. But some may view it as encouraging that these proposals were excluded from the Green Book.

The Green Book also does not include a proposal to repeal or modify the $10,000 aggregate limitation that was imposed by the TCJA on the itemized deduction for state and local income taxes, property taxes, and sales tax for taxable years 2018 through 2025. Modifying or repealing this limitation has been identified as a high priority issue by some members of Congress, and this issue could be raised during consideration of legislation later this year.

XII. Conclusion

Just as guidance under TCJA has been largely completed, the Green Book is proposing significant changes to the tax system that again could force a re-thinking of decisions relevant to real estate. It may be necessary to reconsider structuring of real estate investments, the timing and method for disposing of assets, compensation arrangements regarding investment management for real estate, along with numerous other decisions.

The Green Book represents only the recommendations of the Biden Administration, and it is not clear whether all or any of the provisions ultimately will be enacted into law in the form described here. But with the Democratic party in control of the White House and both legislative branches, and the revenue produced by these proposals intended as an offset to fund Democratic spending priorities, the Green Book is a document that should be taken seriously. Time will tell the ultimate fate of each of the Green Book proposals. In the meantime, it will be important to monitor the progress of negotiations around these proposals and recognize in planning the various outcomes that are possible.